

HOUSE BILL 2945  
By Rinks

AN ACT to amend Tennessee Code Annotated, Title 67, Part 2 and Title 67, Part 4, relative to a seed capital qualified investment tax credit.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF TENNESSEE:

SECTION 1. Tennessee Code Annotated, Title 67, Part 2, is amended by adding a new part consisting of Sections 2 through 9 of this act.

SECTION 2. As used in this part, unless the context other requires:

(1) "Administrator" means the commissioner of economic and community development, or the commissioner's designee;

(2) "Family member" means a spouse, child, grandchild, parent, spouse's parent, or grandparent;

(3) "Net state income tax liability" means a taxpayer's state income tax liability under §67-2-102 reduced by all other credits and exemptions defined by §67-2-104;

(4) "Participates in the operation of a qualified business" means a taxpayer, the taxpayer's family members or an employee of any of these individuals, who provides services of any nature to the qualified business for compensation, whether as an employee, a contractor or otherwise. However, a person who provides services to a qualified business as an officer, board member, or otherwise does not participate in its operations if the individual receives as compensation only reasonable reimbursement of expenses incurred in providing the services, participation in a stock option or stock bonus plan, or both;

(5) "Principal owner" means one who:

(A) Participates in the control of the business and who, together with others, owns fifty percent (50%) or more of the eligible business, or

(B) Participates in the management of the business on a full-time basis;

(6) "Qualified business" means a business that:

(A) Is located in Tennessee;

(B) Is formed as a corporation, partnership, or limited liability company and is in good standing and authorized to do business in the state;

(C) Operates in a qualified trade or business;

(D) Is the full-time, professional activity of at least one of the principal owners;

(E) Is less than three (3) years old as of the date of application as a qualified business;

(F) Has annual gross sales of three million dollars (\$3,000,000) or less; and

(G) Has not received an aggregate amount of qualified investments in excess of six hundred thousand dollars (\$600,000);

(7) "Qualified investment" means a cash investment that meets the following criteria:

(A) The investment purchases the equity securities of a qualified business;

(B) The purchase of the equity securities is not subject to a broker's fee or commission or other similar remuneration paid or given directly or indirectly for solicitation of the purchase;

(C) The investment is made under an agreement where the qualified business may not repay the investment to the taxpayer within two (2) years of the date in which the qualified business receives the investment proceeds;

(D) The investment must remain entirely at risk of loss and repayment of principal, and any return must depend entirely upon the success of the qualified business;

(E) The qualified business must expend the entire proceeds of the investment for plant, equipment, research and development, marketing and sales activity, or working capital for the business;

(F) The taxpayer's aggregate qualified investments in one (1) or more qualified businesses do not exceed two hundred thousand dollars (\$200,000); and

(G) The taxpayer's cumulative qualified investments in one (1) or more qualified businesses do not exceed two hundred thousand dollars (\$200,000).

A qualified investment does not include existing investments that have been purchased, transferred, or otherwise obtained without providing new capital to a qualified business;

(8)

(A) "Qualified trade or business" means any trade or business that primarily involves:

(i) Research and development, technology transfer, biotechnology, information technology, or the application of new technology developed through research and development or acquired through technology transfer; or

(ii) Any trade or business that brings significant capital into Tennessee.

In determining whether a business brings new capital into the state, the administrator will consider whether the investment will:

(i) Create jobs within the state;

(ii) Produce sales tax revenue for the state; and

(iii) Result in new capital being brought into the state in an amount at least equal to the amount of the corresponding credit sought under this part within two (2) years of the granting of the credit.

(B) A qualified trade or business does not include:

(i) Any trade or business involving the performance of services in the field of law, engineering, architecture, accounting, actuarial science,

performing arts, consulting, athletics, financial or brokerage services, or any trade or business where the principal asset of the trade or business is the reputation or skill of one (1) or more of its employees; or

(ii) Any banking, insurance, financing, leasing, rental, investing, or similar business; or

(iii) A real-estate-related business. A business that is involved in or related to the brokerage, selling, purchasing, leasing, operating, or managing of hotels, motels, nursing homes or other lodging facilities, golf courses, sports or social clubs, restaurants, storage facilities, or commercial or residential lots or buildings in a real estate-related business. A real estate-related business does not include:

(a) A business that purchases or leases real estate from others for the purpose of providing itself with facilities from which to conduct a business that is not itself a real-estate-related business; or

(b) A business that is not otherwise a real-estate-related business but that leases, subleases, or otherwise provides to one (1) or more other persons a number of square feet of space that, in the aggregate, does not exceed fifty percent (50%) of the number of square feet of space occupied by the business for its other activities;

(9) “Research and development” means designing, creating, or formulating new or enhanced products, equipment, or process and conducting scientific or technological inquiry and experimentation in the physical sciences with the goal of increasing scientific knowledge that may reveal the basis for new or enhanced products, equipment, or processes; and

(10) “Technology transfer” means the transfer of technology from one (1) sector of the economy to another, including the transfer of military technology to civilian

applications, civilian technology to military applications, or technology from public or private research laboratories to military or civilian applications.

### SECTION 3.

(a) For taxable years beginning on or after January 1, 2004, a taxpayer shall be allowed a credit against the taxpayer's net state income tax liability in an amount equal to twenty-five percent (25%) of the taxpayer's qualified investments. The aggregate amount of credit that a taxpayer may claim per taxable year under this part shall not exceed fifty percent (50%) of the taxpayer's net state income tax liability.

(b) The total amount of tax credits available under this part for qualified investments made on or after January 1, 2004, but before January 1, 2005, shall not exceed three million dollars (\$3,000,000). The total amount of newly available tax credits under this part for each calendar year beginning on or after January 1, 2005, shall not exceed four million dollars (\$4,000,000). In the event that taxpayers do not request the total available tax credits in a given year, the administrator shall add any remaining available tax credits to the subsequent year's newly available tax credits.

### SECTION 4.

(a) The administrator shall be responsible for developing a qualified business application, making the applications available to businesses, and assisting businesses in preparing the applications. The application shall include at a minimum:

- (1) General information identifying and describing the business;
- (2) The business's gross annual sales for the preceding year;
- (3) The business's formation date; and
- (4) The intended use of any qualified investment proceeds.

The administrator shall not issue a tax credit certificate to a taxpayer corresponding to an investment into a business before the administrator's receipt of the business's qualified business application.

(b) A business shall file with the administrator an application, a business plan, a two hundred dollar (\$200) non-refundable fee, and any other information the administrator may require. The administrator, within four (4) weeks of receiving a

completed application, shall determine whether the business is a qualified business and shall promptly send the business either a qualified business certificate or written notice of the reasons the business does not meet the qualified business criteria.

(c) Each qualified business that receives a qualified investment shall file an annual report with the administrator no later than January 31 of each subsequent year the business is certified as a qualified business. This report shall include:

- (1) Whether the applicant is a minority-owned business;
- (2) The number of jobs the business created during the preceding year;
- (3) The average wages paid; and
- (4) The preceding calendar year's gross revenues.

In the event that a qualified business fails to meet the program's reporting requirements, the administrator shall revoke the qualified business certification and rescind the tax certificates attributable to the qualified investments made during the calendar year for which the report is required until the administrator receives the report. If the administrator does not receive the qualified business's annual report by March 31, the administrator shall notify the department of revenue regarding the rescinded tax credit certificates.

(d) The administrator deems a qualified business that exceeds three million dollars (\$3,000,000) in annual sales no longer eligible as a qualified business for the subsequent year. A business may re-apply as a qualified business in the following year if its gross sales fall below three million dollars (\$3,000,000) and the business is less than three (3) years old at the time of re-application.

(e) A qualified business may sell or otherwise transfer its qualified business certificate only if it enters into a merger, conversion, consolidation, or other similar transaction with another business and the surviving company otherwise meets the qualified business criteria.

## SECTION 5.

(a) The administrator shall be responsible for developing a taxpayer application, making the applications available to taxpayers, and assisting taxpayers in preparing the

applications. Only natural persons may claim the credits provided under this part.

Natural persons ineligible to claim the credit include:

(1) A principal owner or a spouse of a principal owner of a qualified business;

(2) A family member of a principal owner if the person has any existing ownership interest in the qualified business;

(3) A taxpayer, or any of the taxpayer's family members or any entity affiliated with the taxpayer, that receives or has received compensation from the qualified business in exchange for services provided to the business as an employee, officer, director, manager, consultant, independent contractor, or otherwise in connection with or within one (1) year before or after the date of the taxpayer's qualified investment; and

(4) A taxpayer who participates in the operation of the qualified business within two (2) years of the qualified investment date.

(b) Eligible taxpayers shall file an investor application accompanied by a one hundred dollar (\$100) non-refundable fee with the administrator. The administrator shall review the investor's application within four (4) weeks after the submission of a completed application and shall issue a formal approval of tax credit status or reject the application. After receiving notice of approval from the administrator, a taxpayer, within a period of time determined by the administrator, may make the investment and may apply to the administrator for a tax credit certificate.

## SECTION 6.

(a) Upon the administrator's satisfaction that the taxpayer has made the investment in the proper form, the administrator shall issue the taxpayer a tax credit certificate indicating the allowable credit amount. Taxpayers may claim the allowable credit amount on the tax return applicable to the taxable year in which the taxpayer made the qualified investment. In the event that the allowable credit amount exceeds fifty percent (50%) of the taxpayer's net state income tax liability, the taxpayer may claim any unused portion of the credit in the subsequent tax year for a period of up to seven

(7) years. A taxpayer shall combine any carry-forward amount with all available credit amounts before applying the fifty percent (50%) net state income liability test. The department of revenue shall establish guidelines taxpayers must follow to claim the allowable credit amount.

(b) In the event that taxpayers request credits in excess of the available credits, the administrator shall grant each taxpayer a pro-rated share of the available credits. The administrator shall base this allocation on timely filed applications and will not subsequently adjust the allowable amounts for credits applied for but not subsequently claimed by taxpayers. In the event of an allocation, the administrator shall notify the taxpayer of the amount of the reduction of allowable credit on or before January 31 of the year following the calendar year of the qualified investment date.

#### SECTION 7.

(a) A taxpayer shall recapture any previously claimed credits and forfeit any remaining unclaimed tax credit in the following events:

(1) The administrator revokes the certification as a qualified business because information in the registration application was false at the time the business filed the application;

(2) The taxpayer materially participates in the operation of the qualified business within two (2) years of the investment date;

(3) The qualified business makes a redemption with respect to the securities received for the qualified investment within two (2) years of the investment date; or

(4) The taxpayer transfers any of the securities received in the qualified investment within two (2) years of the investment date.

(b) The department of revenue may impose any applicable interest and penalties on the recaptured credits. The taxpayer must also pay the department of revenue a penalty in the amount of twenty-five percent (25%) of the total allowable credit amount stated on the tax credit certificate.

#### SECTION 8.



(a) A taxpayer may not transfer any of the securities received for a qualified investment within two (2) years after the investment date. Exceptions to this holding requirement include a transfer resulting from:

(1) The death of the taxpayer;

(2) A final distribution in liquidation to the owners of a qualified business that is a corporation or other entity; or

(3) A merger, conversion, consolidation, or similar transaction requiring approval by the owners of the qualified business under applicable state law to the extent that the taxpayer does not receive cash or tangible property in the transaction.

(b) A qualified business may not make repayments to the taxpayer except for dividends during the two-year period following the investment date. This limitation does not limit the return on investment in the form of dividends that a taxpayer may receive during a qualified investment's required holding period.

#### SECTION 9.

(a) The administrator does not endorse a business or the prudence of an investment by certifying a qualified business or by issuing tax credit certificates. The administrator does not review the financial or business prospects of any business or review or approve any materials used by the qualified business to solicit qualified investments.

(b) The administrator shall notify the department of revenue regarding any revocation or disallowance of tax credit certificates. The administrator shall maintain a publicly accessible list of qualified businesses. The list shall include each qualified business's name, addresses, and the nature of the business.

(c) The administrator and the department of revenue shall each issue an annual report to the Tennessee department of economic and community development and to the general assembly regarding the activity under this part. The respective reports shall reflect both the annual and cumulative figures for each line item.

(d) The administrator shall issue its annual report by the first business day of the third month following each calendar year. The report shall include the following information:

- (1) The number of entities applying for certification as a qualified business;
- (2) The number of entities certified as a qualified business;
- (3) The names and addresses of the entities certified as a qualified business;
- (4) The number of individuals applying for the tax credit;
- (5) The number of tax credit certificates issued;
- (6) The amount of tax credit certificates issued;
- (7) The number of investments made by taxpayers;
- (8) The amount of investments made by taxpayers;
- (9) The number of qualified businesses receiving qualified investments;
- (10) The number of jobs created by qualified businesses receiving qualified investments; and
- (11) The average amount of wages paid by these new jobs.

(e) The department of revenue shall issue its report by October 1 of each year.

The department's report shall include the following information:

- (1) The number of taxpayers claiming the tax credit; and
- (2) The amount of credits claimed by taxpayers.

SECTION 2 This act shall take effect July 1, 2004, the public welfare requiring it.